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DEPT FOR EAP/CM, INR/B, EEP/TRA/AN  
USDOC PASS BUREAU OF ECONOMIC ANALYSIS  
USDOC FOR ITA DAS KASOFF, MELCHER, OCEA  
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SUBJECT: ALIBABA WORKS MAGIC DESPITE ECONOMIC DOWNTURN

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¶1. (SBU) Summary: Hangzhou, the provincial capital of Zhejiang Province, prides itself on its rapidly growing high-tech sector.

City leaders often draw comparisons between the city and Silicon Valley, citing the symbiosis of its numerous high-tech companies and rich academic community. Perhaps nothing better symbolizes Hangzhou's drive to be a high-tech capital than home-grown Alibaba.com, the world's largest business-to-business sales network. During a November 2008 meeting with the Consul General and a February 2009 follow-up meeting with Econoff, Alibaba.com executives reported that business is continuing to grow despite the economic crisis, at least in part because more businesses were turning to online procurement to shave costs. Alibaba executives also discussed business environment issues, labor issues, and intellectual property (IP) among other topics.  
End summary.

Alibaba's Big Umbrella

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¶2. (SBU) Alibaba.com belongs to Alibaba Group, the largest e-commerce company in China. Besides Alibaba.com, Alibaba Group includes: Taobao, China's largest e-commerce company (80 percent market share in China, with one third of China's population as users); Alimama, China's largest online advertising exchange platform; Alipay, China's largest online payment service (100 million registered users - roughly twice the number of Chinese with credit and debit cards); Yahoo! Koubai, an online classified listings for local services and search; and Alisoft, an Internet-based business management software company, which targets SMEs in China. Jack Ma, a former school teacher, founded Alibaba in 1999 with a loan of USD 2,000. He has since become an icon in the Chinese business world and was recently listed by BusinessWeek as one of the world's top 25 most influential people on the web.

Global Commerce Turns to E-trade in Lean Times

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13. (SBU) In a November 2008 discussion, Alibaba.com CEO David Wei said the global downturn had little impact on business as many companies have turned to e-commerce to reduce costs. He noted that immediately after the financial crisis started there was actually an upsurge in orders for goods as many companies decided to save money by sourcing products on-line rather than coming to China directly to buy. Buyers and sellers tend to more readily use e-trade in lean times, Wei noted. In a February 2009 discussion, Alibaba.com Director of Credit and Payment Division Gao Jing confirmed that the membership base and trading volume continue to grow, but Alibaba executives are unsure exactly how much can be attributed to firms seeking to cut costs through less expensive means of procurement. Wei added that even if the company experienced a slowdown, it would still be in good shape since it has low debt and a large amount of cash on hand. Currently Alibaba.com has over 29 million domestic users and 7 million international users. Approximately 17 percent of the international users are from the United States.

#### Strategy Changes with the Times

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14. (SBU) Wei estimated there are approximately 50,000 SMEs within China alone that use Alibaba's services. Alibaba's top priority is penetrating small and medium-size enterprises (SMEs). Currently only one percent of all Chinese SMEs and

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three percent of Chinese exporters subscribe to Alibaba. Wei said the vast majority of Alibaba's income is derived from subscription fees that are paid on a yearly basis. He added that virtually all of its current subscribers choose to renew each year. Only about 15 percent of Alibaba's revenue comes from "value-added" services. Alibaba is not focused on serving big companies, but some big companies use Alibaba for sourcing products. About 100 of the Fortune 500 are registered customers. As of yet, Alibaba has no direct competitors, although Google and Microsoft may soon be in the running.

15. (SBU) Wei said that in August 2008, Alibaba launched a new program specially dedicated to assisting foreign businesses export to China as a way of tapping into the increased demand in China for foreign products. The program is currently in the pilot phase with only 2,000 suppliers. He believed the appreciated value of the RMB can be credited for whetting the appetite of Chinese for foreign products. The response has been "astounding" with three to four thousand requests from Chinese SMEs every day for foreign products. The company plans on expanding the site in 2009. U.S. trade associations, such as the U.S. Wine Association, have approached Alibaba about selling their products through the site as a way to "cut-out" distributors in China. Wei said the main products requested thus far from the Chinese importers are: luxury products, second hand machines, and chemicals and raw materials. The last category is by far the best-selling. According to a March 14 Shanghai Daily news report, Alibaba is currently exploring relationships with companies such as Google, eBay, Yahoo! And Microsoft to expand its business network. Alibaba sent over a dozen of its executives to the United States in late February for preliminary discussions.

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¶16. (SBU) Wei rated Hangzhou's business environment as very supportive. Although Alibaba does not receive financial support from the municipal, provincial and central government, Wei said the "moral support" at all levels was very good. He added that part of the reason for the broad support was because Alibaba is not involved in the media or on-line gaming.

#### Alibaba Welcomes Cooperation with the United States

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¶17. (SBU) Wei emphasized that Alibaba would like a closer working relationship with the Consulate and the U.S. business community, suggesting a number of avenues for cooperation. In particular, he welcomed U.S. business associations' ideas for collaboration and suggestions on ways Alibaba.com can improve business. Wei also offered to assist U.S. businesses wishing to export to China, saying Alibaba would list their businesses the first year without charge. In addition, Wei said that Alibaba receives many requests from their customers who experience difficulties obtaining U.S. nonimmigrant visas. Many are "verified and trusted business partners" who hope to travel to the United States for business reasons.

#### The Three-Pronged Attack on IP Infringement

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¶18. (SBU) Wei said with over 120 million products listed on  
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Alibaba, it is impossible to track whether all are legitimate. The "illegal stuff" is easy to ferret out, but it is the gray area of IP infringement that causes trouble, according to Wei. The company has built a "knowledge base" to help track infringement and those companies and individuals that may engage in such sales. Protecting patents and designs is particularly difficult on the internet, but trademarks are more easily verified and protected. Wei described Alibaba as having a "three-pronged" approach to protecting IP. The first method is through the company's automatic filter that checks and screens for possible counterfeit material. Second, there are approximately 60 to 70 employees that screen postings everyday, checking for illegal and pirated material. Last, the company takes complaints from rights holders and acts promptly to investigate. Wei stressed that rights holders themselves need to be vigilant about counterfeits. Often, unless the rights holder approaches Alibaba, the company has no way of knowing if the product is legitimate or is being distributed legally. If the rights holder objects to the sale of an item on Alibaba's site on the basis of IP infringement, the item is immediately de-listed. Wei said the biggest illegal activity Alibaba has found on its site is cigarette smuggling and illegal distribution.

¶19. (SBU) Regarding Yahoo! Koubei, Wei said that it uses filters to ensure that its search engine cannot be used to access illegal music and movie downloads. Yahoo! Koubei also tries to steer clear of media and entertainment. Alisoft, Alibaba.com's sister company, which develops, markets, and delivers Internet-based business management software, uses programs which

are "impossible" to copy. Through its leasing programs, it is actually helping "kill software piracy" in China by making software affordable to the average Chinese SME. Alisoft only charges 1 RMB per day per user for each software application. He said approximately 600,000 customers legally lease Microsoft software through Alisoft. Alisoft currently leases 165 software applications, 162 of which are developed by other companies. It then "rents" these software applications to other companies and pays a royalty fee to the software owner.

¶10. (SBU) Alibaba also finds that its IP rights are being infringed as hundreds of copycat websites attempt to lure Alibaba companies away. Wei noted that these websites have not only copied Alibaba's user content, but have even copied the company's user contract. Since these copycats are hard to pinpoint and are able to change so fast, it is impossible for Alibaba to protect its own IP one hundred percent of the time.

#### A Labor Force to Match the Task

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¶11. (SBU) Wei said Alibaba has approximately 1,000 IT engineers working at its Hangzhou headquarters, fifty percent of whom have graduated from a post-graduate program. In total, Alibaba Holdings has over 12,000 employees and is now the second largest tech company in the world, after Google. Gao added the company continues to expand despite the economic downturn. According to Wei, Alibaba is set to open its new 1.3 million square meter campus in the summer of 2009 to coincide with its 10-year anniversary. Wei said the campus is equipped with state-of-the-art technology and is environmentally friendly. In total, approximately 8,500 people will be working there. Alibaba also has 300-400 people employed in Shanghai.

¶12. (SBU) According to Wei, Alibaba actively cooperates with Zhejiang University and about 200 other educational institutions throughout China. The company funds a post-graduate program at Zhejiang University at no cost to the university. Alibaba also

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sends its IT engineers to teach at many universities around China. According to Wei, the company has an intern program, and about 25 percent of the interns stay with the company after the internships conclude. As for corporate social responsibility, Wei said that rather than assist poor students, Alibaba has a corporate program to assist teachers. Alibaba sponsors a number of low-income teachers throughout China as a means to help people, who in turn help a greater number of other people.

#### Internet Freedom - Shying Away from the Sensitive

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¶13. (SBU) Wei noted that Alibaba, as the owner of Yahoo! China, is not interested in on-line media, entertainment or gambling, so it attempts to steer Yahoo! China towards commercial activities and away from sensitive topics. Alibaba has developed an internal filter system that screens for objectionable material on its Yahoo! China website. Wei also showed the CG the company's web-casting studio which broadcasts two live shows daily and has a viewership of roughly 300,000. However, content is primarily commercial issues. Alibaba also

allows companies to post video clips introducing their products.  
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